COVID-19 Economic Recovery Roadmap

Cook Islands economy in the wake of COVID-19

The economic contraction experienced by the Cook Islands as a result of the COVID-19 pandemic and necessary travel restrictions has been one of (if not the) largest in the world, with a peak-to-trough fall in GDP estimated to be close to 32 per cent over 15 months[1].

This fall has hit the trade balance of the Cook Islands hard, with revenues raised from tourism activities drying up overnight, in what is the largest component of GDP (worth approximately $1 million per day, or $368 million per year, pre-COVID). As well as this direct impact, the indirect impact of falling incomes has seen reductions in consumption of goods and services produced domestically and overseas, and these impacts together have reduced business incomes. With lower incomes and the very high degree of uncertainty around the economy until borders remain open for some time, private investment is not expected to recover quickly. The government support under the Economic Response Plan (ERP) from April 2020 through to June 2021 has kept the economy from contracting further, and helped to minimize the pain felt by people and businesses of the Cook Islands, but cannot continue indefinitely.

As visitors return, causing tourism receipts to grow from zero, and the ERP winds down, new areas of focus to grow Gross Domestic Product (GDP) towards pre-COVID levels are needed, and will include a mix of policy and expenditure from both public and private sectors.

The recovery from this severe recession will not occur overnight, and the following 8 areas of focus will be key to driving and facilitating the recovery. These areas are:

- Reducing the cost of borrowing (lowering interest rates for borrowers)
- Managing the burden of public debt (in particular reducing the interest rates charged CIG)
- Infrastructure investment
- Reducing barriers to competition and business
- Productivity growth
- Improved public sector efficiency
- Growing the labour force and preventing depopulation
- Attracting foreign investment that will benefit the Cook Islands.

[1] Asian Development Outlook, 2021

1. Reducing the cost of borrowing

Currently the Cook Islands has an extremely high cost of finance – with interest rates on property and business commonly above 8 or even 10 per cent across the three domestic banks, and spreads around 5 percentage points. This high cost of borrowing is a significant impediment to private investment in the Cook Islands, and lowering this will encourage a stronger recovery in investment – in turn driving both GDP immediately and in the future through increased capital and productivity.

A number of reviews have been completed in the past suggesting a range of factors lead the cost of borrowing to be so high. These factors include a lack of scale, higher risk profile, the impact of land tenure on the assessment of collateral and a relative lack of competition. Government is committed to exploring as many avenues as is necessary to lower these costs, to help reduce the impediments to private investment. By reducing the cost of finance for people and businesses, this will open up opportunities for greater entrepreneurship and expansion into potential new industries or models of business, as well as reducing the burden of debt.

One of the issues keeping costs higher in the banking sector is a lack of competition, with only three retail banks (2 privately owned, and the government-owned Bank of the Cook Islands). Encouraging greater competition could be a means to lowering costs – whether this is through more entrants to the market, or fostering a more competitive marketplace is something to investigate.

As shown in Table 1, high rates of borrowing are not unusual across the Pacific, though the Cook Islands still appears to have a higher cost than some comparable countries. For example in Niue, which is also a Realm country, mortgages are available at 5 per cent, where in the Cooks this is over 2.5 percentage points higher. American Samoa also lacks the ability to increase supply of currency to lower costs, yet have borrowing costs around 1 percentage point lower than the Cook Islands.

Table 1: Borrowing rates across the Pacific, selected countries (latest available data)

Country	Type of credit	Rate (range)	Own currency?
Cook Islands	Mortgage rates	7.69% - 8.53%	No - NZD
Cook Islands	Business credit	7.66% - 8.57%	No - NZD
Samoa	Commercial Bank lending rate	8.50%	Yes
American Samoa	Home loans variable	6.79%	No - USD
Fiji	Lending interest rate	6.03%	Yes
Vanuatu	Lending interest rate	2.00%	Yes
Solomon Islands	Lending interest rate	10.75%	Yes
Papua New Guinea	Lending interest rate	8.65%	Yes
Palau	First Home Owner Loan	8.00%	No - USD
Tonga	Lending interest rate	8.07%	Yes
Tonga	Home loans variable	8.65%	Yes
FSM	Commercial Bank lending rate	7.60%	No - USD
FSM	Business credit	15.70%	No - USD
Guam	Mortgage rates	2.75%	No - USD
Niue	Mortgage rates	5.00%	No - NZD
Niue	Business credit	7.5% - 9%	No - NZD
New Zealand	Home ownership	2.49%	Yes

In brief: The high cost of finance is an impediment to investment for many people in the Cook Islands, reducing the opportunity for business to expand, diversify and take opportunities.

EDS Actions related to this: 2.6, 4.13

2. Managing the burden of public debt

In order to provide critical support to the Cook Islands economy through the pandemic, the government has increased the level of debt held by the country. This increase in debt comes with ongoing costs associated with servicing the debt, so it is crucial that the large increase in debt is managed effectively and efficiently.

Interest rates across most of the world have been pushed to almost zero in the past year and a half, which has allowed countries to borrow with very cheap costs. With the increased debt now held by the Cook Islands, it is imperative that this is at the cheapest possible interest rate to keep the burden as low as possible. Keeping this burden low allows government to use resources in other areas to support people and the economy through the severe recession. Discussions with partners such as New Zealand and the Asian Development Bank have shown that these institutions also recognize the importance of keeping borrowing costs low.

In brief: The Cook Islands has taken on more debt through the crisis, and keeping the interest rates on that debt as low as possible will keep the burden of servicing that debt manageable.

EDS Actions related to this: 4.1

3. Infrastructure investment

Cook Islands GDP has seen a dramatic reduction as a result of the pandemic, with many businesses having had their incomes reduced to almost zero (aside from government support) throughout the last 15 months, meaning the outlook for private investment in the short-term is not positive. In order to both step in to replace the activity that would ordinarily result from private investment and to invest in projects which will improve our standard of living, the Cook Islands Government is pursuing an ambitious infrastructure investment approach.

This approach faces challenges such as capacity limitations on the amount of capital investment that can be undertaken. To expand this capacity, government will work with development partners to utilize expertise as well as access funding to enable this investment to occur. This investment will utilize previous work such as the National Infrastructure Investment Plan (NIIP) to identify appropriate projects, as well as provide the economic stimulus needed.

Activity in this space will lead to employment opportunities in the Cook Islands, and engagement opportunities for local businesses – even when specific skill sets are required from abroad. This increased investment expenditure is a key component of the economic recovery of the Cook Islands, and assists in preparing for future and present needs.

Estimates of the level of private investment in the Cook Islands are not readily available, however some analysis suggests that in the 2018-19 year, there was around $35 million of private investment[2]. With this investment likely to reduce severely in the short term, government investment is needed to fill this gap. Recent evidence suggests that the upper bound on annual government capital works is around $40 million – meaning assistance and expertise from development partners is likely to be critical in maximizing the amount of investment possible.

In brief: To bring the economy back to where it was before the pandemic, and create jobs and income for Cook Islanders, investing in key infrastructure building is going to play an important role.

EDS Actions related to this: 4.7, 5.9, 5.10, 5.11

4. Reducing barriers to competition and business

One of the challenges faced in a small economy such as the Cook Islands is creating and promoting competition in the marketplace. With many industries already being monopolies (such as electricity generation on each island), this leads to inefficient outcomes, higher prices for consumers and economic rents being collected by the monopolists (which is in some cases government).

To reduce the instances where this is the case (and in some industries it will remain a natural monopoly), the Cook Islands government has already set up an independent Competition and Regulatory Authority (CRA) to promote competition and prevent anti-competitive practices. This will reduce barriers to the private sector growing and help push the economy along through activity and innovation, increasing incomes and providing employment. The CRA is also developing a Universal Access Plan to support equity for consumers in the Pa Enua in terms of access to services.

The overall regulatory environment in the Cook Islands is not currently conducive to business and international investment, with burdensome and unclear regulations around how to start a business in a particular industry. This red tape stymies competition through protectionism for existing businesses, leading to poorer outcomes for consumers and inefficiencies in several key areas of the economy. Reducing these barriers and streamlining processes will allow for potential new entrants to the market, creating greater competition and more economic activity in both the short and long term.

In brief: Regulations make it harder for new businesses to get a start in the Cook Islands, resulting in higher prices and less diversification. Reducing and removing these regulations will help encourage more activity and opportunity.

EDS Actions related to this: 1.11, 2.4, 2.6, 4.1, 4.11, 4.12

5. Productivity growth

Investment in the Cook Islands, both public and private, stimulates demand for goods and services and builds the future capacity of local businesses and overall economic development. This is a key component in improving productivity, alongside improved education and skills training which will increase our incomes and grow our economy.

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[2] This is a very approximate measure – arrived at as a residual when accounting for other components of GDP. Work with Peter Griffin (ADB TA) has suggested a similar magnitude.

On the government side, improving productivity can bring considerable and sustainable benefits. A more efficient and effective public sector helps ensure the nation's resources are being used efficiently and are making the greatest contribution to wellbeing

Improved public sector productivity also matters for the private sector. For example, publicly funded education and training increases the supply of skilled workers and entrepreneurs. Therefore, productivity improvements in public services are likely to contribute to better economic performance, which frees up resources for other opportunities.

In brief: Key investments will improve the ability of both public and private sector to increase capacity in the future, and grow the economy.

EDS Actions related to this: 2.9, 2.10, 3.14, 3.15, 3.18

6. Improved public sector efficiency

Due to the challenges faced by a small, remote nation, the public sector of the Cook Islands plays a proportionally larger role in the economy than that of a larger nation with more economic diversity. This is especially true in the Pa Enua, where the smaller populations and limited links to the wider world mean private sector activity is very limited.

The large role played by the public sector makes improving the efficiency of that sector even more important. There are a number of paths for this improvement to take, with various ministries and public sector bodies working more closely together likely to yield more immediate gains. The EDS outlined a number of longer-term approaches to improving public sector efficiency, such as a public expenditure review and agency core functions review. This work may identify areas where work is unnecessarily duplicated across government, or where improvements in processes could lead to improved efficiency, amongst other areas.

Greater efficiency in the public sector will allow for resources to be redirected to addressing other priorities, and providing support in manners which are not currently possible.

In brief: Improving the performance of our public sector will free up resources to be directed to other priorities, increasing the standard of living.

EDS Actions related to this: 2.7, 2.9, 2.10, 3.15

7. Growing the labour force and preventing depopulation

The Cook Islands faces an issue of a declining population due to emigration and if this decline is not addressed, it will significantly impact economic growth going forward – particularly our labour force. Adding to this, the commencement of the quarantine-free travel for passengers from the Cook Islands into New Zealand in January 2021 has seen a significant number of people of working-age migrating to New Zealand for employment opportunities.

As New Zealand citizens, Cook Islanders have ease of labour mobility with New Zealand and Australia. The 2018 New Zealand census estimates that approximately 80,000 people have Cook Islands heritage in New Zealand. This is in addition to approximately 22,000 people of Cook Islands heritage residing in Australia. This is a significant resource that remains largely untapped.

In order to increase the number of workers, and skills available to the Cook Islands economy, a key pillar will be a targeted approach to attract Cook Islanders back to live in the Cook Islands. This will involve establishing a coordinated network of the diaspora to allow Cook Islanders abroad to more easily contribute to the economic development of the Cook Islands. There is also a strong case to be made for looking into simplifying the immigration requirements and reducing barriers to entry in order to grow our labour force and address various needs in the economy.

In brief: COVID-19 led to a further decrease in population and labour force which needs to be reversed so our economy has the skills and numbers needed to generate activity and incomes.

EDS Actions related to this: 3.2, 3.3, 3.7

8. Attracting foreign investment that will benefit the Cook Islands

The existing foreign investment environment in the Cook Islands is not particularly welcoming for potential investors, with most (if not all) potential industries being considered "Reserved Investment Areas" and only open to foreign investment via exemption. This restriction, along with other similar barriers (and the high cost of borrowing) have limited the amount of investment which occurs in the Cook Islands to predominately only that which is domestically-funded. This has led to the current situation where the level of private investment is lower than would be optimal, reducing the opportunities for employment and income-generating assets in the economy.

A foreign-investment free-for-all is not proposed, as there remain some areas of the economy which it is appropriate to preserve for local activity only. However, the current environment is too-strongly biased against allowing foreign investment across the board. By allowing a prudent level of foreign investment to occur in the Cook Islands, the economic recovery can occur more quickly, and greater opportunities for the future can be unlocked.

In brief: Attracting the right mix of foreign investment will allow the economy to grow and potentially open up new industries and markets.

EDS Actions related to this: 1.2, 4.8

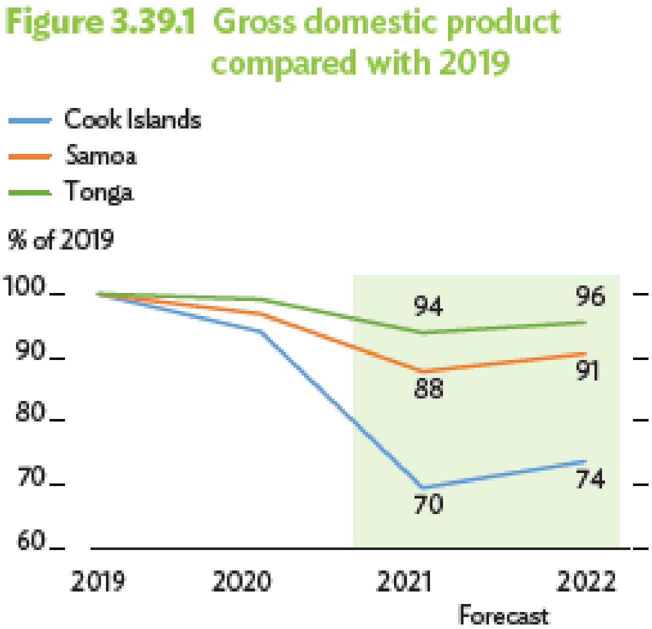
How is COVID-19 impacting the Cook Islands economy?

Prior to March 2020, the Cook Islands had experienced six years of continuous economic growth due to record numbers of visitors. However, the impact of the COVID-19 pandemic on the economy has been severe, with activity reduced by over a quarter in the past 15 months. In the 2019/20 fiscal year, the Cook Islands economy declined by 5.9 per cent in real terms[3] as the borders closed to tourists in mid-March, causing the large contraction to begin in the June quarter.

In 2020-21, the impact of the pandemic was felt throughout most of the year, with visitors only returning in May as the economy was estimated (by the ADB) to decline by a further 26.0 per cent – despite unprecedented support from government in the form of the Economic Response Plan (ERP), which amounted to over 20% of GDP in total. Most of the ERP spend was funded through borrowing.

The economic outlook is largely determined by the speed at which visitors begin to return to the Cook Islands, with the New Zealand market the only one currently open[4]. The speed of this recovery (and the long-term economic health of the Cook Islands) will also depend on this recovery roadmap being implemented to supplement the return of visitors.

Figure 1: Impact on GDP, selected countries (Asian Development Outlook, April 2021)



Note: Years are fiscal years ending on 30 June of that year.
Sources: Cook Islands Ministry of Finance and Economic Management; Samoa Bureau of Statistics; Tonga Department of Statistics; Asian Development Bank estimates.

[3] Asian Development Outlook, April 2021
[4] As of May 17th

Relative to the rest of the world

The Cook Islands is undoubtedly one of the hardest hit economies in the world through the COVID-19 pandemic, with only Macau and the Maldives (slightly) showing larger economic contractions[5]. This shows how severe the downturn has been for the nation, as well as the importance of this recovery plan and how crucial it is for the Cook Islands.

Something that is made very clear when looking at the worst-affected countries is how tourism-dependent economies have seen the largest economic impact of this pandemic. With the exceptions of Libya and Venezuela, all of the twenty largest declines in GDP in the 2020 calendar year are from tourism-reliant economies, often in the Pacific or Caribbean.

Table 2: Pandemic Impact on GDP, worst-affected countries (IMF/ADB)

Country	Decline in GDP
Macau SAR	-56.3%
Maldives	-32.1%
Cook Islands	-31.9%
Aruba	-25.5%
Palau	-19.6%
Fiji	-19.0%
St. Lucia	-18.9%
St. Kitts and Nevis	-18.7%
Panama	-17.9%
Barbados	-17.6%

[5] Libya also saw a larger contraction (59.7%) according to the IMF, however this is unlikely to be solely pandemic-related and is not a useful comparison. For a similar reason, Venezuela (30% decline) has also been excluded from this table. Data from a combination of the IMF's *World Economic Outlook* and *Asian Development Outlook*, both in April 2021.

Appendix: Economic Development Strategy 2030: Relevant Actions

No.	Action	Lead Agency	Details	Indicative timing
1.2	Consider incentives for long-term worker accommodation	MFEM	As part of the Revenue Strategy, assess the merits for further incentivising tourism operators to build long-term housing for their staff	2021-22
1.11	Universal Access Plan	Competition & Regulatory Authority (CRA)	Develop a Universal Access Plan in consultation with Pa Enua residents	2021
2.4	Extend remit of Competition & Regulatory Authority	MFEM	Regulation policy and legislation to extend the CRA's remit to the electricity, water and sewerage utility sectors	2021
2.6	Review of banking sector competition	FSC	Competition review and recommendations to Government	2021
2.7	PEFA review	MFEM	Public Expenditure and Financial Accountability review by the IMF	2021
2.9	Public expenditure review	MFEM	Review the performance and expenditure of all agencies every four years	2022
2.10	Agency core functions review	OPSC	Review of core functions to improve efficiency	2022
3.2	Population study	OPM	Study to increase the understanding of the drivers behind population movements	2022
3.3	National Population Strategy	OPM	Research and development of a national population strategy for the Cook Islands	2022
3.7	Diaspora Network	MFAI	Establish a formal diaspora network for communication, including promotion of activities, available jobs and procurement in the Cook Islands	2021
3.14	Apprenticeship Scheme	CITTI/ MOE/MFEM	Develop a pilot apprenticeship scheme in the Cook Islands	2022
3.15	Public sector lifelong learning policy	OPSC	Review and develop policy to deliver training and development opportunities for public sector employees	2022

Appendix: Economic Development Strategy 2030: Relevant Actions

No.	Action	Lead Agency	Details	Indicative timing
3.18	Tertiary Strategy	MOE/CITTI/USP	Develop a strategy to ensure the tertiary education system is responsive to demands of the labour market, structured efficiently and maximises student outcomes, including a review of teacher training	2022
4.7	NZ Infrastructure fund	MFEM	Implement the Fund	Ongoing
4.7	NZ Infrastructure fund	MFEM	Implement the Fund	Ongoing
4.8	Foreign investment framework review	MFEM/BTIB	Comprehensive review of the current foreign investment framework to ensure that it is fit for purpose	2022
4.11	Online 'One-stop Business Info Shop'	BTIB	Develop and publish guides that identify and describe requirements to comply with key business regulatory processes	2021
4.12	Business start-up support	Chamber of Commerce	Establish a mentoring and assistance mechanism for business start-ups	2021
4.13	Banking Taskforce	FSC/MFEM	Explore the future direction of the domestic banking sector, including sustainable options to reduce the cost of credit	2022
5.9	MTVKTV investment decision	MFEM	Government to decide on whether to proceed to the construction phase	2021
5.10	Sanitation Masterplan	MFEM/PMU	Finalise the draft Masterplan	2021
5.11	Public sanitation	CIIC/ICI/CITC	Improve public sanitation services	2022

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